LIFE ASSURANCE POLICIES

APRIL 2023

Life assurance policies are insurance policies where an amount (the **sum assured**) is paid out when an individual (the **life assured**) dies, in exchange for **premiums** paid into the policy. Those **without** any underlying investment content are pure life insurance, and are covered in our notes on Protection.

Those **with** an underlying investment content can be used either to primarily deliver life insurance, or as an **investment vehicle** with an incidental amount of life cover. The latter are usually called **investment bonds**.

Here we look at life assurance policies used primarily as investment vehicles, where they might be suitable, and look in detail at how the taxation regime of investment bonds contrasts to other popular forms of investment.
Some life assurance policies are not taken out as a means of purely providing life insurance. Both regular and single premium life assurance policies are often marketed as investment products. Such regular premium life assurance policies are often called endowments, and such single premium life assurance policies are usually marketed as investment bonds. This is not to be confused with the asset class of fixed interest investment into corporate or government bonds.

Life assurance policies with an investment content are structured as an insurance wrapper, within which investments are held, usually collective investment funds (e.g. unit trusts, investment trusts). The tax treatment of this wrapper both internally and on the investor differs markedly from the treatment in place for direct investments into such holdings.

The suitability of a life assurance policy will depend upon the quality and choice of investment funds offered within the policy, the taxation of the policy compared to the individual’s own tax position, and the level of charges incurred under the policy. The additional product wrapper involved in an insurance bond often means an additional layer of charges.

For many investors, the current relatively low rate of capital gains tax means that more suitable options can often be found outside the insurance policy arena, e.g. direct holdings in collective investment funds such as unit trusts or OEICs. In addition, life assurance policies can be inflexible and high charging, offering particularly poor value if surrendered in the early years.

There are, however, situations where life assurance policies can meet investors’ needs, and specialist advice must be taken. For example, an investment bond may be considered for an investor who regularly crystallises capital gains in excess of their CGT annual exemption, and who may be a lower rate tax payer (or even a non-UK resident) at the time of future withdrawals above the 5% level allowed.

An ISA investment should always be considered as a preference, as a tax-advantaged investment wrapper. Please see our Research Note on ISAs for further details.
TYPES OF LIFE ASSURANCE POLICY

Life assurance policies are generally split into two main types, **qualifying** and **non-qualifying**, which affect how they are subject to tax in the hands of the investor.

**QUALIFYING POLICIES**

If a policy meets qualifying criteria then **no charge to tax** usually arises at maturity or on a death claim. If the policy is surrendered or made paid up within ten years (or three-quarters of the term if sooner), then a chargeable gain could arise.

Qualifying criteria include:

- Regular level premiums.
- Premiums payable at least annually.
- Premiums payable for at least ten years.
- Since April 2013, written in single ownership only.
- Since April 2013, the maximum level of annual contributions is £3,600; applying to all policies which are beneficially owned by an individual; part owners will be deemed to be full owners.
- Where a policy is assigned after 5 April 2013, it will lose its qualifying status, unless as a result of a divorce settlement, court order, between spouses or into trust.

The qualifying rules are more complicated than this, however, and individual situations should be discussed with a financial adviser or the life office. These types of policies generally include policies such as endowments and some whole of life policies.

**NON-QUALIFYING POLICIES**

These are generally single premium policies, usually taken out for investment rather than life cover reasons. As life policies, however, they will also contain some minimal element of life cover, typically 1% or 0.1% of the value. These types of policies are often called investment bonds (although bear no relation to investment in corporate bonds), but can also include certain types of whole of life policy.
**PERSONAL TAXATION**

No liability to personal taxation will usually arise on a qualifying policy, although please note the comments above regarding the taxation paid within the life assurance fund and early surrenders; also the low maximum contribution limit from April 2013. The generally high charges on these contracts can also mean that the tax benefits are largely reduced.

On a non-qualifying policy, a liability to personal taxation may occur if all of the following conditions are met:

- A chargeable event occurs – including death, maturity, surrender, part-surrenders above the 5% limit (see below), assignment for money or monies worth, and on some policy loans.
- A chargeable gain arises – confusingly, any gain is actually taxed to income tax, not capital gains tax. No relief is available for losses except in some limited situations where a loss has been made overall when the policy is terminated, but gains have previously arisen on partial surrenders.
- If the gain, when added to the investor’s total income in that year, falls within the higher or additional rate tax brackets, the gain is taxed at the higher rate less the deemed internal life fund taxation rate of 20%, giving a net charge of up to 25%. ‘Top slicing’ relief, calculated according to the number of years the policy has been held, is available for basic rate tax payers where the gain brings them into the higher or additional rate tax brackets.

**ONSHORE LIFE FUND TAXATION**

Irrespective of whether a policy is qualifying or non-qualifying, the taxation treatment of the fund within the policy wrapper is the same. The taxation of life insurance companies is complicated, however, in relation to the life insurance funds, the company is subject to tax at 20% on interest income, property rental income and overseas dividend income, with UK equity dividends exempt. Capital gains are taxed at 20%, after indexation allowance. The company is able to offset management expenses against the investment income for tax purposes.

These taxes are paid directly by the insurance company and cannot be reclaimed by the policyholder. Life assurance funds will therefore not generally be suitable for non tax payers. Basic rate taxpayers benefit from a 20% tax credit when gains are triggered, which is generally higher than the effective tax rate paid by the fund manager.

Compared to an equivalent collective investment vehicle such as a unit trust, where no tax is charged on internal capital gains, the life assurance fund will therefore generally grow at a lower rate over the long term. A more detailed comparison is attached in the Appendix to this Research Note.
PERSONAL TAXATION

5% WITHDRAWALS

Under present legislation the policyholder can withdraw up to 5% of the initial investment each year for up to 20 years, with no immediate charge to tax. If no 5% withdrawal is made one year, the allowance rolls forward into future years. This defers the tax payable until the policy matures (or another chargeable event occurs), which can be useful for those who are currently higher rate taxpayers, but believe they will become basic rate taxpayers in the future, for example in retirement, or who believe they may become non-UK resident in the future. As ever, this facility depends on current legislation and could be withdrawn in the future.

GIFTING LIFE ASSURANCE POLICIES

A life policy can be gifted to another person or a trust, and no income tax charge will arise on the gift provided this is made for no consideration. For non-qualifying arrangements, the income tax on any eventual profits will depend upon the identity of the recipient:

1. An outright gift of the policy to an adult recipient – any future gains are assessed on the recipient.

2. An outright gift of the policy to a minor – any future gains would be assessable on the new owner. However, the minor cannot usually surrender the policy, so no gains will arise until the owner is an adult, at which time any gains will be assessed on the owner as above.

3. Policies held in trust, where the settlor is alive and UK resident in the tax year in which the gain arises – the profits will be taxed in the hands of the settlor, who can then recover the tax, where possible, from the trustees.

4. Policies held in trust, where the settlor is dead or non-UK resident in the tax year in which the gain arises, and one or more of the trustees is UK resident – the profits will be taxed in the hands of the trustees, at the applicable trust rates. This tax cannot be reclaimed by the beneficiaries, even if they are basic rate taxpayers. If the trustees are not resident in the UK, any UK beneficiary receiving benefit from the gain will be taxed at their own tax rates, and not eligible for top slicing relief.

5. An exception to the above rules on trusts is that where a policy is held on absolute trusts for an adult beneficiary or beneficiaries, the trust is ignored and the beneficiary/beneficiaries assessed.

Single premium bonds can usually be constructed with multiple lives assured so there may be no chargeable event until the last of the lives assured. If you consider a situation of a 60 year old parent establishing a bond in trust with 20 year old children who have a life expectancy of 80 and beyond it is clear that a chargeable event can be avoided for a very long time – until the last of the children dies.

The use of a suitable trust assists this process. The trustees can make distributions to beneficiaries, often using the 5% tax deferred annual facility. For distributions in excess of 5%, tax will be due at the trust rate on the chargeable event amount, or if the bonds are part assigned to beneficiaries who then surrender them, tax will be at the beneficiaries’ tax rates.
PERSONAL TAXATION

In the case of younger beneficiaries in their 20s, the tax rate may then be nil if the bond is onshore and 20% if offshore - assuming they are basic rate taxpayers. Due to the flexibility of the offshore bond this structure is often combined with a trust to assist with Inheritance Tax Planning.

OFFSHORE LIFE ASSURANCE POLICIES

The principle differences between onshore and offshore bonds will be in terms of tax treatment (see below) and investor compensation. Although most offshore financial centres have financial compensation schemes equivalent to the UK, the actual level of regulation may not be as robust as in the UK.

The main form of offshore life assurance policy sold is the single premium investment bond. As the bond does not suffer UK tax (although may be subject to withholding taxes on dividends received), there is no internal tax to offset. Investor’s liability to income tax on a chargeable event is therefore charged at their full marginal rate, i.e. 45% for an additional rate taxpayer, 40% for a higher rate taxpayer or 20% for a basic rate taxpayer. However, management expenses cannot be offset against income for tax purposes, as with onshore bonds - this is one of the reasons that offshore bond charges tend to be higher than onshore bond charges.

CHARGES

With any insurance product it is worth remembering that the initial and to an extent recurring annual costs are determined by the level of commission or fee that the adviser/salesman takes from the insurance company, which can be a significant amount of the premium invested, especially in the less regulated offshore sales markets. If the adviser charges you a fee directly and does not take commission then the charges are likely to be far more reasonable.

Annual fees for providing the insurance contract vary significantly from company to company and also with the amount invested. The advent of investment fund platforms has driven down costs for onshore and offshore investment bonds accessed via these routes, but charges should still be very carefully checked to ensure they are not excessive.

In all cases you will also pay the annual management charge of the underlying funds that you invest in. However, you would pay these charges even if you invested directly in the funds without the life assurance wrapper.
## COMPARISON WITH NON-LIFE ASSURANCE FUNDS

It is helpful to contrast the tax treatment of non-qualifying onshore and offshore policies (investment bonds) with the tax treatment of the underlying funds as if they were purchased and held directly by the investor. This is summarised below. Please note that this is intended to cover the main aspects only, and is not intended to be exhaustive.

### COMPARISON OF TAX SITUATION OF INVESTMENT VEHICLES

#### Taxation Within the Wrapper

<table>
<thead>
<tr>
<th></th>
<th>Onshore Investment Bond</th>
<th>Offshore Investment Bond</th>
<th>Unit Trusts (including OEICs/ICVCs)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income Tax</strong></td>
<td>Insurance company funds are subject to tax at 20% on interest, rental income and overseas dividend income. UK dividend income is exempt. The company can offset the management expenses against the investment income.</td>
<td>No income tax is charged on income within the investment bond. UK dividend income is exempt. However, irrecoverable withholding tax may be suffered.</td>
<td>Income, in the form of interest, rent or from overseas dividends, received by the Unit Trust is subject to Corporation Tax at 20%. UK dividend income is exempt. The company is able to offset management expenses and interest paid against taxable income.</td>
</tr>
<tr>
<td><strong>Capital Gains Tax</strong></td>
<td>Capital gains within the fund are taxed at 20%</td>
<td>No capital gains tax is charged on capital gains realised within the bond.</td>
<td>Internal capital gains within an authorised Unit Trust are exempt from tax.</td>
</tr>
</tbody>
</table>
# COMPARISON WITH NON-LIFE ASSURANCE FUNDS

## COMPARISON OF TAX SITUATION OF INVESTMENT VEHICLES

### Taxation on the Individual

<table>
<thead>
<tr>
<th></th>
<th>Onshore Investment Bond</th>
<th>Offshore Investment Bond</th>
<th>Unit Trusts (including OEICs/ICVCs)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Crystallisation of Tax</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Withdrawals within 5% limits can be made without immediate charge to tax. Chargeable gains on withdrawals above these limits are subject to income tax. There is therefore some scope to defer crystallising gains until a tax year where income is at a lower marginal rate, or when non-UK resident (5 year rule applies).</td>
<td></td>
<td>The holder is assessable to income tax on income and dividends as they are received by the fund manager, regardless of whether they are distributed. Capital gains are taxed on sale. There is therefore some scope to defer crystallising gains until a tax year where income is at a lower marginal rate, or when non-UK resident (5 year rule applies). Switching between funds will trigger a chargeable gain/loss.</td>
<td></td>
</tr>
<tr>
<td>Switching between funds within a bond does not trigger a chargeable event.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Position on Death</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A chargeable event will be triggered on death of the life assured (or last surviving life assured) as for any other chargeable event, and income tax may be chargeable in addition to inheritance tax if the life assured was the owner of the policy. However, if the bond is written into trust, then the value may not fall into the settlor's estate for inheritance tax purposes.</td>
<td></td>
<td>No capital gains tax applies on death, and value is uplifted to current value for beneficiaries. Inheritance tax may apply.</td>
<td></td>
</tr>
</tbody>
</table>
## COMPARISON WITH NON-LIFE ASSURANCE FUNDS

### COMPARISON OF TAX SITUATION OF INVESTMENT VEHICLES

#### Taxation on the Individual

<table>
<thead>
<tr>
<th></th>
<th>Onshore Investment Bond</th>
<th>Offshore Investment Bond</th>
<th>Unit Trusts (including OEICs/ICVCs)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital Gains Tax</strong></td>
<td></td>
<td></td>
<td>Capital gains on disposal subject to capital gains tax, with annual exemption and offset of capital losses available to reduce the gain. Transfers can also be made between husband and wife to take advantage of both individual’s allowances and tax rates.</td>
</tr>
<tr>
<td></td>
<td>All chargeable gains are subject to income tax, therefore no opportunity to use CGT annual exemption or offset capital losses.</td>
<td>All chargeable gains on disposal subject to capital gains tax, with annual exemption and offset of capital losses available to reduce the gain. Transfers can also be made between husband and wife to take advantage of both individual’s allowances and tax rates.</td>
<td></td>
</tr>
<tr>
<td><strong>Income Tax</strong></td>
<td>All chargeable gains are subject to income tax. The starting rate savings tax band and personal savings allowance may be available only to the extent it offsets any tax payable. Reclaim of the tax credit is not available.</td>
<td>All chargeable gains are subject to income tax. The starting rate savings tax band and personal savings allowance may be available only to the extent it offsets any tax payable.</td>
<td>Income payments from non-equity Unit Trusts are paid gross, and taxed as interest, with the starting rate savings tax band and personal savings allowance available to be used against this. Dividends are paid gross and taxed to dividend rates, with the dividend allowance available for the first £1,000 (23/24) of income.</td>
</tr>
</tbody>
</table>
# COMPARISON WITH NON-LIFE ASSURANCE FUNDS

## COMPARISON OF TAX SITUATION OF INVESTMENT VEHICLES

### Taxation on the Individual - Tax Status

<table>
<thead>
<tr>
<th></th>
<th>Onshore Investment Bond</th>
<th>Offshore Investment Bond (including OEICs/ICVCs)</th>
<th>Unit Trusts</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non Taxpayer</strong></td>
<td>No further tax liability on any gains (unless chargeable gains push income into the next tax bands in which case top slicing relief available). Tax deducted at source on the underlying fund cannot be reclaimed.</td>
<td>Income tax is payable on the chargeable gain at applicable rate(s) only if the gain takes the investor beyond the savings rate tax band and personal savings allowance (£1,000 for non-tax payers). Top-slicing relief may be available if the gain takes the investor into the higher rate brackets. Withholding tax suffered is not reclaimable.</td>
<td>No further tax liability and all interest/dividends received gross in any case. Any gain will be subject to capital gains tax.</td>
</tr>
<tr>
<td><strong>Basic Rate Taxpayer</strong></td>
<td>No further tax liability on any gains (unless chargeable gains push income into the next tax bands, in which case top slicing relief is available). Tax deducted at source on the underlying fund cannot be reclaimed.</td>
<td>Chargeable gain taxed at basic rate of income tax (20%), after taking account of any savings rate tax band and personal savings allowance (£1,000 for basic rate taxpayers). Top-slicing relief may be available if the gain takes the investor into the higher rate bracket. Withholding tax suffered is not reclaimable, therefore overall rate of tax suffered may be higher than basic rate.</td>
<td>Tax payable at 20% for interest income (above applicable savings rate tax band and personal savings allowance of £1,000) and 8.75% for dividends above dividend allowance of £1,000 (23/24). Any gain will be subject to capital gains tax.</td>
</tr>
</tbody>
</table>
## COMPARISON WITH NON-LIFE ASSURANCE FUNDS

### COMPARISON OF TAX SITUATION OF INVESTMENT VEHICLES

**Taxation on the Individual - Tax Status**

<table>
<thead>
<tr>
<th>Onshore Investment Bond</th>
<th>Offshore Investment Bond</th>
<th>Unit Trusts (including OEICs/ICVCs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher Rate Taxpayer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Any chargeable gain will be subject to the difference between basic rate (20%) and higher rate (40%) income tax, i.e. at a further 20% on the net gain. Overall rate of tax may therefore be less than 40%, depending upon the life company’s marginal rate of tax.</td>
<td>Chargeable gain taxed at higher rate of income tax (40%) after taking account of any savings rate tax band and personal savings allowance (£500 for higher rate taxpayers). Withholding tax suffered is not reclaimable, therefore overall rate of tax suffered may be higher than 40%.</td>
<td>Tax payable at 40% for interest income (above applicable savings rate tax band and personal savings allowance of £500) and 33.75% for dividends, above dividend allowance of £1,000 (23/24). Any gain will be subject to capital gains tax.</td>
</tr>
<tr>
<td>Additional Rate Taxpayer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Any chargeable gain will be subject to the difference between basic rate (20%) and additional rate (45%) income tax, i.e. at a further 25% on the net gain. Overall rate of tax may therefore be less than 45%, depending upon the life company’s marginal rate of tax.</td>
<td>Chargeable gain taxed at additional rate of income tax (45%) after taking account of any savings rate tax band. No personal savings allowance available. Withholding tax suffered is not reclaimable, therefore overall rate of tax suffered may be higher than 45%.</td>
<td>Tax payable at 45% for interest income (above applicable savings rate tax band, with no personal savings allowance available) and 39.35% for dividends, above dividend allowance of £1,000 (23/24). Any gain will be subject to capital gains tax.</td>
</tr>
</tbody>
</table>
COMPARISON WITH NON-LIFE ASSURANCE FUNDS

COMPARISON OF TAX SITUATION OF INVESTMENT VEHICLES

Taxation on the Individual

<table>
<thead>
<tr>
<th>Onshore Investment Bond</th>
<th>Offshore Investment Bond</th>
<th>Unit Trusts (including OEICs/ICVCs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment bonds are non-income producing assets. Details of the bond do not have to be included until a chargeable event is triggered, and at such time the relevant details must be included in the Self Assessment return.</td>
<td>For those liable to file Self Assessment returns, income and capital gains usually need to be declared.</td>
<td></td>
</tr>
</tbody>
</table>
COMPARISON WITH NON-LIFE ASSURANCE FUNDS

COMPARISON OF TAX SITUATION OF INVESTMENT VEHICLES

Taxation on the Individual - Residency

<table>
<thead>
<tr>
<th>Onshore Investment Bond</th>
<th>Offshore Investment Bond</th>
<th>Unit Trusts (including OEICs/ICVCs)</th>
</tr>
</thead>
</table>
| **Investors who become resident outside the UK**
(NB UK tax position only – local tax may also be charged depending on county of residency)
No change to taxation of underlying investments within bond - funds continue to be subject to UK taxation. No UK tax is charged on chargeable gains realised whilst the investor is non-UK resident (although tax suffered on the underlying fund cannot be reclaimed), unless period of non-residency does not exceed five complete tax years, in which case the gain becomes subject to income tax on return to the UK. |
No change to taxation of underlying investments within bond – non-reclaimable withholding tax continues to be suffered on some dividend income. No UK tax is charged on chargeable gains realised whilst the investor is non-UK resident, unless period of non-residency does not exceed five complete tax years, in which case the gain becomes subject to income tax on return to the UK. |
No change to taxation within Unit Trust. On individual, dividend and interest income not subject to further UK tax. Capital gains tax is only charged on gains which are realised in non-UK residency on assets acquired when UK resident, where period of non-residency does not exceed five complete tax years (i.e. gains become chargeable to UK tax when become resident again during this time). |

**Investors who return to the UK after living abroad**
Onshore investments are still subject to UK taxation rules. Time apportionment relief available for new or assigned policies after 5 April 2013. |
Time apportionment relief available - may reduce tax liability on any gains or reduce a loss, e.g. if an investor lived outside the UK for 3 years of a 10 year investment, only 70% of the gain is taxable. Top-slicing relief is not available for the years of non-residency. |
Investments are still subject to UK taxation rules. If period of residency outside the UK has exceeded five complete tax years, base cost of holdings can be ‘rebased’ by sale and reinvestment prior to return to UK residency. |
FIND OUT MORE

If you have any questions about our investment methodology, or would like some financial planning or investment advice, the clarity team are here to help.

Please contact your usual clarity adviser, or get in touch using the details below:

Tel: +44 800 368 7511
Email: enquiries@clarityglobal.com
Address: 1 Crown Square, Woking, Surrey GU21 6HR
Web: clarityglobal.com
Twitter: twitter.com/clarityglobal
Instagram: instagram.com/clarity_global
LinkedIn: linkedin.com/company/clarity_7

Important information: Our views are based upon our understanding of current legislation in England, unless stated otherwise. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances. This document is provided for information only and does not constitute advice. You should not act on any of the information without seeking professional advice.

Risk Warning: The past is not necessarily a guide to future performance. The value of your investment and the income from it can fall as well as rise and is not guaranteed. You may not get back the full amount invested.

© clarity Ltd. clarity Ltd is authorised and regulated by the Financial Conduct Authority (FCA). The FCA does not regulate all types of Pensions, Mortgages or Taxation Advice. clarityLAW is brought to you in association with Taylor Vinters solicitors, a firm regulated by the Solicitors Regulatory Authority.